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TAGS: EFIN ECON PGOV EINV PREL NI
SUBJECT: NIGERIA: BANK CAPITALIZATION - OVERHEATING, OR OVERBLOWN?

REF: A. LAGOS 00654

¶B. MOSS/TANSEY EMAILS

SENSITIVE BUT UNCLASSIFIED -- PLEASE HANDLE ACCORDINGLY.

¶1. (SBU) Summary: Nigeria's bank reforms, recapitalization, and consolidation in the sector have been positive and in line with other macroeconomic and financial reforms. Rapid capitalization has raised the issue of possible overheating if Nigeria's commercial banks rush to push available funds to a limited set of customers. In our view, overheating is unlikely to occur, at least in the short-term, because the Nigerian banking system is not yet mature, and loans to industrial and infrastructure projects remain limited. Banking experts contend that rates, rather than holdings, will determine how much money flows from the newly-consolidated banks into the domestic economy, and managing a share of Nigeria's growing foreign exchange reserves may be the main impetus for the continuing strong capitalization trend. GON policymakers may need to adjust the regulatory environment to encourage longer-term lending as well as access to capital markets to promote industrial development. End summary.

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Could Positive Banking Reforms Lead to Overheating?
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¶2. (U) Nigeria's bank reforms, recapitalization, and consolidation over the past two years have been positive and in line with other macroeconomic and financial management reforms. Reftel reported on the second phase of capitalization and the status of bank mergers and acquisitions. Clearly, the banks have accumulated large capital reserves. The extent of rapid capitalization raises the question of possible overheating if Nigeria's commercial banks rush to push available funds to a limited set of customers.

Unlikely, At Least in the Short-term

¶3. (SBU) In our view, overheating is unlikely to occur, at least in the short-term. In some significant ways, the Nigerian banking system is not yet mature, and loans to industrial and infrastructure projects remain limited. While the banks are expanding their business base, as noted in reftel, they still tend to focus on "easier" areas like trade letters of credit and retail banking, but are very conservative loaning to the real sector.

¶4. (SBU) Industrialists tell us they face effective interest rates of 20-30 percent. The banks also strongly prefer short-term loans--thus borrowing to build factories or improve infrastructure remains difficult. The Chairman, of First Bank, Nigeria's largest commercial bank, told Econcouns that his bank would not/not accept some of the applications resulting from its capitalization offers, because it can not/not make productive use of all the money. He said other banks will make similar judgments.

¶5. (SBU) First Bank is venturing into West Africa and even Europe. It has a full-fledged branch in London, a rep office in South Africa, is applying to establish an office in China, and has been interested in the U.S. market for some time. First Bank has other interests in property development, both within Nigeria and elsewhere. Asked about the possibility of overheating and whether First's recent capital accumulation will make its way into Nigeria as new working and investment capital, the chairman again pointed out the bank's interest in other West African countries and Europe. He himself was headed to South Korea via Dubai to explore other international possibilities, following attendance at the 2007 World Bank/IMF meetings in
Washington.

¶6. (SBU) There is little evidence that the process of capitalization and consolidation to date has actually led to increased lending to the real sector. Experts on the banking sector tell us that rates, rather than holdings, will determine how much money flows from the newly-consolidated banks into the domestic economy. As also noted in reftel, some experts believe that the opportunity to manage a share of Nigeria's growing foreign exchange reserves may be the main impetus for the continuing strong capitalization trend.

But, Could Capitalization be Overblown?

¶7. (SBU) At this point, it is possible that Nigeria risks going too far with bank capitalization; bank capitalization has dominated financial markets to the point that it is probably pulling funds away from other productive uses. In 2006, the Nigerian Stock Exchange considered and approved 62 applications for new issues plus mergers and acquisitions, valued at 1.4 trillion naira, compared to 52 applications worth 731 billion naira in 2005. The banking sector accounted for 41 percent of the volume of issues in 2006, with 21 applications valued at 577 billion naira. Forty non-bank corporate issues totaled 679 billion naira. Contacts outside the banking sector complain to us that those benefiting from non-bank corporate issues are already well-established, such as members of the Dangote Group of companies, while less well-known firms have difficulty accessing capital markets.

¶8. (U) As for the banks' own lending, it is not contributing strongly to the much-needed growth of Nigeria's industrial base. A report by Augusto and Company, Nigeria's foremost rating agency, on the state of Nigeria's banking sector in 2006 showed that bank lending to the real sector has not yet accelerated. The report shows that the banks still concentrate on trading and general commerce, including export financing, importation, and other intermediation activities. Twenty-nine percent of lending went to trading and general commerce. Manufacturing received only 15 percent of cumulative credit in 2006.

Time to Re-direct?

¶9. (SBU) Comment: It may not be in the best interest of the Nigerian economy for banks to focus mainly on capital markets

for funds. Banks are eager to mobilize money in that way, while non-bank enterprises don't have the option of building up a capital base from savings deposits. Future success requires policy makers and regulators to improve conditions in support of longer-term bank lending to industrial and infrastructure projects, while making it easier for non-bank borrowers to also access capital markets. Otherwise, there is the possibility that Nigeria could develop a rich banking sector while investments that provide employment and diversify the economy remain neglected. End comment.
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